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The Real Tragedy of Persistent Unemployment

By Mohamed El-Erian

June's employment report was disappointing. Though the national unemployment rate fell slightly – it's now at 9.5% from 9.7% in May – the report reveals deep structural problems that go beyond the number of those who remain without jobs.

Almost half of unemployed Americans have been without a job for over six months. The average duration of unemployment, which hit a post-World War II record many months ago, continues to go up. Last month it clocked in at 35 weeks. Unemployment is particularly severe among the young: A quarter of Americans between 16 and 19 years old in the labour market are without a job.

The longer it takes to understand and address these issues, the more likely the US will get stuck in a protracted low growth/high unemployment trap. In addition to considering the welfare cost of substantial joblessness, policymakers should keep in mind the following four facts:

First, persistently high unemployment erodes the skills of any labour force, especially when joblessness is a big problem among the young. This reduces future productivity and growth potential.

Second, a high rate of joblessness puts pressure on inadequate social safety nets like the unemployment benefit system. It also exacerbates the strain on government budgets already stretched at both the federal and state levels.

Third, stubbornly high unemployment makes those who are employed more cautious. By spending less, they aggravate the economic slowdown.

And finally, high unemployment has historically induced companies and countries to become more inwardly oriented. Many firms have already moved to a "self-insurance" mode, including holding large cash balances rather than investing in equipment and hiring people.

Put all of this together, and you begin to get a sense of the importance of the employment reports. They are more than indicators of what has happened; they also shed light on what will likely happen going forward. The greater the persistence of high unemployment now, the higher the likelihood that it will drive future behaviour of governments, companies and individuals.

The reason we are in this difficult situation goes beyond the lack of aggregate demand in today's global economy – a situation that will be aggravated in the months ahead as European countries embark on budget austerity and China seeks to soft land an economy that is subject to excesses in certain sectors, most noticeably real estate.

The US is in the midst of major internal and external realignments for which parts of the labour force are unprepared. Internally, the economy is adapting to an environment of lower credit, general deleveraging, higher regulation and future tax

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increases. Externally, it is adjusting to the impact of emerging economies like China, and the fact that certain European countries are facing increasingly unsustainable debts and deficits.

To remain successful, firms have no choice but to adapt. Many have begun to do so by resizing their cost structure, increasing cash balances and altering how they use new earnings. For companies, this is a prudent response to the uncertainty associated with national and global policy changes. But to governments, firms come across as unresponsive to stimulus policies.

Instead of simply debating the case for further government stimulus, policymakers should also come up with a comprehensive strategy that focuses on improving human capital, particularly through a greater emphasis on education and training; expanding infrastructure and technology investments, in part by creating a more friendly tax system; encouraging a bigger translation of scientific advances into economy-wide productivity gains; and better protecting the most vulnerable segments of society.

By presenting a multiyear policy proposal, lawmakers will help companies and individuals navigate what is currently a highly fluid and uncertain outlook. The longer this is delayed, the greater the damage that will result from today's tragic employment picture.

About the author:

Dr. El-Erian is CEO and co-CIO of PIMCO and is based in the Newport Beach office. He re-joined PIMCO at the end of 2007 after serving for two years as president and CEO of Harvard Management Company, the entity that manages Harvard's endowment and related accounts. Dr. El-Erian also served as a member of the faculty of Harvard Business School. He first joined PIMCO in 1999 and was a senior member of PIMCO's portfolio management and investment strategy group. Before coming to PIMCO, Dr. El-Erian was a managing director at Salomon Smith Barney/Citigroup in London and before that, he spent 15 years at the International Monetary Fund in Washington, D.C. Dr. El-Erian has published widely on international economic and finance topics. His book, *When Markets Collide*, was a *New York Times* and *Wall Street Journal* bestseller, won the *Financial Times*/Goldman Sachs 2008 Business Book of the Year and was named a book of the year by *The Economist*. Dr. El-Erian has served on several boards and committees, including the U.S. Treasury Borrowing Advisory Committee, the International Center for Research on Women, and the IMF's Committee of Eminent Persons. He is currently a board member of the NBER and the Peterson Institute for International Economics. He holds a master's degree and doctorate in economics from Oxford University and received his undergraduate degree from Cambridge University.

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